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IN THE

Supreme Court of the United States

CHARLES V. DUFFY, Collector of Internal Revenue for the United States for the Fifth District of New Jersey, Petitioner, *v.* THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Respondent.	No. 129, October Term, 1924.

BRIEF FOR RESPONDENT THE CENTRAL RAILROAD COMPANY OF NEW JERSEY

Statement of the Case.

The writ of certiorari allowed in this case brings before the Court a decision of the Circuit Court of Appeals for the Third Circuit affirming a judgment of the District Court for the District of New Jersey entered in favor of the Railroad Company in an action instituted to recover back a portion of the income tax assessed against it for the year 1916.

It appears from the agreed statement of facts upon which the case was tried below that the gross income of the Railroad Company for the year 1916 was $35,854,392.03 (R., p. 5).

The Government concedes that the Railroad Company was entitled to deduct therefrom $30,112,403.68, and that as the result of a miscalculation the tax assessed against it is excessive by $37,781.54 (R., pp. 5, 13).

The question presented for decision in this case is whether the Railroad Company is entitled to additional deductions aggregating $1,659,-924.33. If it is, the tax assessed against it is excessive by $70,980.03 (R., p. 13), the amount for which it obtained judgment below (R., p. 17).

The deductions thus in controversy represent amounts expended during the year 1916 for improvements to properties held by the Railroad Company under lease. The Revenue Act of 1916 provides as follows:

> "Sec. 12 (a). In the case of a corporation, joint stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> "First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property, to which the corporation has not taken or is not taking title, or in which it has no equity."

The Railroad Company contends that since the leases under which these properties were held required it to make the improvements involved, it is entitled to deduct the amounts so expended upon the ground that they were rentals or other payments required to be made as a condition to the continued use or possession of property, and that if they were rentals or payments required to be made as a condition to the continued use or possession of property, it is entitled to deduct the full amount of all such expenditures made within the year.

Statement of the Facts.

Of the $1,659,924.33 expended by the Railroad Company for improvements to leased properties during 1916, $1,545,798.72 was spent for the construction of piers and extensions to piers, $66.82 was spent for dredging at piers, and $114,058.70 for additions and betterments to leased railroads and branches.

The Expenditures for the Construction of Piers and Extensions to Piers

The expenditures for the construction of piers and extensions to piers were as follows:

New Pier 9 and bulkhead.....	$1,525,308.72
Extension to Pier 46.....	14,486.22
Extension to Pier 39.....	6,003.78

New Pier 9. New Pier 9 was held by the Railroad Company under a lease from the City of New York by which the City leased to the Railroad Company a plot of land under water near the foot of Carlisle Street, in the City of New York. The City agreed to condemn all the right, title and interest of private owners in the existing Old Pier 9 and in the bulkhead, and the Railroad Company agreed to defray the entire cost of such condemnation, including awards, fees of Commissioners and experts, and all other necessary disbursements.

The lease further provided that on the vesting of title to such property in the City, the Railroad Company should at once proceed with the improvement of the water front by building a new Pier 9, a stone bulkhead wall, sheds on the pier

and on the marginal street extending inshore a distance of 50 feet from the bulkhead, and by filling in in the rear of the bulkhead, and paving the marginal street in accordance with plans, specifications and estimates of cost approved by representatives of the City.

The Railroad Company agreed to pay 27½ cents per square foot per annum for the portion of the demised premises not acquired from private owners, and the sum of $1.00 per year for the property so acquired from private owners. It was provided, however, that if the cost of the improvements, including the entire cost of the condemnation proceeding, the cost of building the new pier, bulkhead wall, sheds, etc., and of filling in in the rear of the bulkhead and paving the marginal street, should be less than $2,750,000, the Railroad Company should pay annually, in addition to the above amount, 5½ per cent. on the difference between $2,750,000 and such entire cost; that if the cost of the improvements should be greater than the sum of $2,750,000, the Railroad Company should be credited upon the average annual rental for a term of 39 years with an amount equal to 5½ per cent. upon the difference between said cost and the sum of $2,750,000; and in the event that 5½ per cent. on said difference should exceed the average rental, it was provided that the term of the lease should be extended for a period which should bear the same proportion to 39 years as the amount of excess cost over the sum of $2,750,000, plus the sum upon which 5½ per cent. is equal to the amount of rental for the land over that acquired from private owners should bear to $2,750,000.

The lease specifically provided that the piers, bulkhead, sheds or other improvements made or erected in accordance with its terms should re-

vert to and become the property of the City at the expiration or sooner termination thereof.

The term of the lease is for ten years, plus two renewals of ten years each, and a further renewal of nine years, or for such longer period as the Railroad Company may be entitled to in accordance with its terms, in the event that the cost of the improvement exceeds $2,750,000, but on each renewal, the payments provided for increase ten per cent.

Additionally, the lease provided that in the event that the Railroad Comapny should fail to pay the rent for a space of ten days, or to perform, keep, do or observe any or either of the covenants, agreements, things, terms or conditions thereof, the City might terminate the same.

The amount expended during 1916 was for the construction of a new pier and bulkhead in accordance with the terms of this lease (R., p. 9).

Pier 46. Pier 46 was held under a lease from the City of New York, which by its terms expired on October 25, 1924. Under it the Railroad Company was required to construct an extension to the pier and a shed thereon under the direction and supervision of the City authorities, and to pay 27½ cents per square foot per annum for the area of land under water covered by such extension.

The lease specifically provided that the extension and shed should revert to the City at the expiration or sooner termination of the lease, and gave the City the right to terminate it if the Railroad Company should fail to perform the covenants thereof.

The amount expended in 1916 was for the construction of an extension to this pier as required by the lease (R., p. 12).

Pier 39. The lease covering Pier 39 is similar to that covering Pier 46. Under it the Railroad Company was required to build an extension to the pier which reverts to the City on the expiration of the lease, and the City was specifically given the right to terminate the lease if the Railroad Company should fail to perform the covenants thereof.

During 1916 the Railroad Company expended $6,003.78 for the construction of an extension to Pier 39 as required by the lease (R., p. 12).

The Expenditures for Dredging at Piers

The expenditures for dredging at piers were as follows:

Dredging north side Pier 80.....	$28.72
Dredging north side Pier 46.....	38.10

The dredging involved was done at piers in the City of New York which were held by the Railroad Company under leases which specifically required it to do such dredging as the City authorities directed and which specifically gave the City the right to terminate them in the event that the Railroad Company should fail to do such dredging (R., p. 11).

Expenditures for Additions and Betterments to Leased Railroads and Branches

The expenditures for additions and betterments to leased railroads and branches were as follows:

Additions and betterments to Lehigh and Susquehanna Railroad and branches.....	$103,496.68
Additions and betterments to Wilkes-Barre and Scranton Railroad	2,507.35
Additions and betterments to Allentown Terminal Railroad.	232.31

Additions and betterments to Ogden Mine Railroad.....	855.22
Additions and betterments to Dover & Rockaway Railroad..	6,967.23

Lehigh & Susquehanna Railroad and Branches. This road was held under a lease requiring the lessee to maintain and perpetuate the leased line and to keep and maintain it in good order and repair and fit for efficient use. The lease provided that all additions and betterments made by the lessee should, when and as the same are constructed, become part of the demised premises, and the lessor is given the right to terminate the lease upon the breach of its terms.

Additions and betterments made in 1916 included improving the roadbed, right of way and facilities, renewing bridges, increasing the weight of rail, installing siding facilities, installing road crossing bells, installing telephone lines, installing yard tracks, increasing water supply facilities, and replacing and changing signals.

The agreed statement of facts shows that these additions and betterments were required by the terms of the lease under which the line was held (R., p. 5).

Wilkes-Barre & Scranton Railroad. The lease under which the Wilkes-Barre & Scranton Railroad was held contained provisions generally similar to those contained in the lease of the Lehigh & Susquehanna Railroad, and provided that if for any reason the lease of the Lehigh & Susquehanna Railroad should be terminated the lease of the Wilkes-Barre & Scranton should terminate also, and the property revert to the lessor. Under it the lessee is required to make the necessary additions and betterments which revert to the lessor when made, and the lessor is given

the right to terminate the lease upon breach of its terms.

Additions and betterments made in 1916 included renewing a bridge, constructing a passenger station, and increasing the weight of rail.

The agreed statement of facts shows that the additions and betterments made in 1916 were required by the terms of the lease (R., p. 6).

Allentown Terminal Railroad. This line was held by the Railroad Company as tenant in common with another railroad under a lease which required the lessees to maintain and keep the road in good working order, and to bear the cost of all permanent improvements necessary or convenient for the operation, use or enjoyment thereof, and which gave the lessor the right to terminate it upon breach of its terms. It was also provided that the lease should terminate if the above mentioned lease of the Lehigh & Susquehanna Railroad should be terminated.

Additions and betterments made in 1916 included improving track material, rearranging tracks, the construction of a siding and delivery tracks, purchasing additional land, and resetting paving and curbing.

The agreed statement of facts shows that these additions and betterments were required by the terms of the lease (R., p. 7).

Ogden Mine Railroad. The Ogden Mine Railroad was held under a lease which required the lessee to at all times maintain and keep the road and its appurtenances in good repair and condition and in all respects fit for use as a railroad, and which gave the lessor the right to terminate it if the lessee failed to perform any of its covenants.

Additions and betterments made in 1916 in-

cluded the installation of a telephone dispatching system and the acquisition of land.

The agreed statement of facts shows that these additions and betterments were required by the terms of the lease (R., p. 8).

Dover & Rockaway Railroad. This road was held under a lease which required the lessee to maintain and keep it and all its appurtenances in good repair and condition at all times, and in all respects fit for use as a railroad, and which gave the lessor the right to terminate it upon default by the lessee in performing its covenants.

Additions and betterments made in 1916 included renewing bridges, increasing rail weight, improving track material and installing sidings.

The agreed statement of facts shows that the additions and betterments made in 1916 were required by the terms of the lease (R., p. 9).

Argument.

In interpreting statutes levying taxes, the established rule is not to extend their provisions, by implication, beyond the clear import of the language used or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt, they are construed most strongly against the Government and in favor of the citizen. *U. S.* v. *Wigglesworth,* 2 Story 369. *American Net & Twine Co.* v. *Worthington,* 141 U. S. 468, 474; *Benziger* v. *U. S.,* 192 U. S. 38, 55. *Gould* v. *Gould,* 245 U. S. 151, 153.

The Act of 1916 provides that the net income of a corporation shall be ascertained by deducting from the gross income received within the year,

> "First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and

> properties, including rentals or other payments required to be made as a condition to the continued use or possession of property, to which the corporation has not taken or is not taking title, or in which it has no equity."

While the word "including" may "merely specify particularly that which belongs to the genus" it may also be used as a word of enlargement and have the sense of "also" and of "in addition." *Montello Salt Co.* v. *Utah*, 221 U. S., 452, 462, 464, and it is frequently so used by Congress. *U. S.* v. *Pierce*, 147 Fed. 199.

Adopting this latter sense of the word, the Act of 1916 may be read as permitting a corporation to deduct, first, the ordinary and necessary expenses paid in the maintenance and operation of its business and property, and second, rentals or other payments required to be made as a condition to the continued use or possession of property. And, since a tax act must be construed against the Government and in favor of the citizen this act must be so construed.

This being so, it follows that the Railroad Company is entitled to deduct the amounts involved here if they were (1) rentals, or (2) payments required to be made as a condition to the continued use or possession of property, and (3) the Railroad Company had not taken or was not taking title to the properties involved and had no equity in them.

THE EXPENDITURES INVOLVED HERE WERE RENTALS.

In *Miller* v. *Gearin*, 258 Fed. 225 (Certiorari denied, 258 U. S. 667) decided by the Circuit Court of Appeals for the Ninth Circuit, it appeared that an owner of land had made a lease in 1907 which required the tenant to construct

an expensive brick building. On the tenant's default, the owner retook possession of the demised premises in 1916. It was contended by the Government that the value of the building was taxable income which accrued to the landowner in 1916. This contention was rejected by the court, which said:

> "The lessor acquired nothing in 1916 save the possession of that which for many years had been her own. The possession so acquired was not income. It was not a gain, but a loss. Assuming that the building was income derived from the use of the property, we think it clear that the time when it was 'derived' was the time when the completed building was added to the real estate and enhanced its value. *At that time it represented a repayment to the lessor of a portion of the rental,* distributed over a period of 23 years." (Italics ours.)

By the regulations promulgated by the Commissioner of Internal Revenue, under the Revenue Act of 1916 it is provided:

> "Art. 140. Permanent improvements under lease.—The cost of erecting permanent buildings, or of making permanent improvements on ground leased by a company is held to be an additional rental and is therefore a proper deduction from gross income, . . ."

The expenditures involved here, therefore, were rentals.

THE EXPENDITURES INVOLVED IN THIS CASE WERE PAYMENTS REQUIRED TO BE MADE AS A CONDITION TO THE CONTINUED USE OR POSSESSION OF PROPERTY.

Attributing to the word condition its usual and natural significance, it is evident that the statute

permits the deduction of any payments, the failure to make which would entitle the landowner to terminate the use or possession of the property.

In *42 Broadway Company* v. *Anderson* the question was whether a realty corporation having a nominal capital but a large bonded indebtedness secured by mortgages upon its real estate was entitled to deduct the full amount of the interest paid on its bonded indebtedness. The case arose under section 38 of the Corporation Tax Act of 1909, the second paragraph of which, like the Act of 1916, authorized the deduction of charges required to be made as a condition to the continued use or possession of property, but the third paragraph of which authorized the deduction of interest only on an amount of bonded or other indebtedness not exceeding the paid up capital stock.

The District Court for the Southern District of New York (209 Fed. 991), and the Circuit Court of Appeals for the Second Circuit (213 Fed. 777) held that the full amount of interest could be deducted from the gross income notwithstanding the limitation contained in the third paragraph of section 38, upon the ground that the interest payments involved were charges required to be made as a condition to the continued use or possession of the property.

The District Court said, 209 Fed. 992:

> "The interest paid on the mortgages was one of 'the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties,' and it was a charge *'such as rental or franchise payments, required to be made as a condition to the continued use or possession of property.' If*

> *the interest on the mortgages had not been paid, the mortgages would have been foreclosed, the property sold, and the continued use and possession of the property and the entire business of the corporation terminated.*" (Italics ours.)

The Circuit Court of Appeals said, 213 Fed. 778:

> "The government admits that if the interest had not been paid the mortgages would by their terms have fallen due, and if foreclosed the company would have lost its property. It seems to us that these payments of interest on bonds of a corporation engaged in the realty business secured on its realty were ordinary and necessary expenses in the 'maintenance and operation' of such business, and were also charges required to be paid as a 'condition of the continued use or possession' of its property within subdivision 1 of paragarph 2 of section 38."

The case was reversed by this court upon the ground that the lower courts had erred in seeking a theoretically accurate definition of "net income," instead of adopting the meaning clearly defined in the act itself, 239 U. S. 69. The court said, however (p. 72):

> "It may well be that mortgage interest may, under special circumstances, be treated as among the 'ordinary and necessary expenses,' or as included among the charges 'required to be made as a condition to the continued use or possession of property.' (See 28 Opin. A. G. 198.)"

The agreed statement of facts shows that the leases under which the properties involved here were held required the Railroad Company to make the improvements involved, and contained

provisions entitling the lessors to terminate such leases if the improvements were not made. The expenditures for making such improvements, therefore, were payments required to be made as a condition to the continued use or possession of property.

THE RAILROAD COMPANY HAD NOT TAKEN OR WAS NOT TAKING TITLE TO THE PROPERTIES INVOLVED HERE AND HAD NO EQUITY IN THEM.

The words "to which the corporation has not taken or is not taking title, or in which it has no equity," did not appear either in the Corporation Tax Act of 1909 or in the Income Tax Act of 1913. They were included in the Revenue Act of 1916 as the result of a recommendation of the Secretary of the Treasury made after the decisions of the lower courts in *42 Broadway Co.* v. *Anderson, supra, Benders Federal Revenue Law,* 1916, Annotated, p. 64. The purpose of the amendment proposed by the Secretary of the Treasury was to distinguish "between the interest due on liens and mortgages from any payment made in the nature of rentals or charges constituting in the ordinary sense an expense of the business." See report, Secretary of the Treasury, fiscal year ending June 30, 1915, p. 99.

The genesis of the phrase, therefore, suggests that in using the word "equity," Congress had in mind the equity of redemption, which is defined as the remaining interest belonging to one who has pledged or mortgaged his property.

It is to be noted, moreover, that the word "equity" is used in the Act in connection with the word "title," which is defined as "the means whereby the owner of lands hath the just possession of his property." *2 Bl. Comm. 195.*

In view of the genesis of the phrase and of the context in which the word is used, it is submitted that "equity" means equitable ownership, and even if it be possible to give it a broader interpretation, it is the duty of the court to construe it most strongly against the Government. *Gould* v. *Gould, supra.*

The properties involved in this case were held under leases. Ownership of them both at law and in equity remained in the lessors, and the Railroad Company had neither title to nor equity in them. Nor does the fact that some of the leases granted long terms alter the situation, for no matter how long the terms such leases did not operate to transfer ownership either in law or in equity from the lessors to the lessee.

It is urged, however, that while technically the Railroad Company is not the owner of the properties held under long term leases, the court should consider substance and not form, and that viewed in this light the Railroad Company is the *potential owner* of such properties. But this the court may not do, for to do so would enlarge the operation of the statute by construing it in favor of the Government.

SINCE THE EXPENDITURES INVOLVED WERE RENTALS OR OTHER PAYMENTS REQUIRED TO BE MADE AS A CONDITION TO THE CONTINUED USE OR POSSESSION OF PROPERTY TO WHICH THE RAILROAD COMPANY HAD NOT TAKEN OR WAS NOT TAKING TITLE AND IN WHICH IT HAD NO EQUITY, IT IS ENTITLED TO DEDUCT THE WHOLE OF SUCH EXPENDITURES FROM ITS GROSS INCOME FOR THE YEAR 1916.

Since the expenditures involved here are of the kind which may be deducted, it is clear that the statute, by express words, permits the deduc-

tion of all of such expenditures made within the year. There is no hint in the statute that the payments which may be deducted are to be prorated. The words of the statute are "all . . . paid within the year."

In *Mutual Benefit Co.* v. *Herold,* 198 Fed. 199, the District Court of the District of New Jersey dealing with the language employed in the Corporation Tax Act of 1909, which as the Government points out is similar to the language of the Act of 1916, said (p. 215):

> "Since, then, the language of the Act is explicit in permitting only such deductions from the gross income as were actually paid during the current year, it would be strange, indeed, if on the opposite side of the account the Company were charged with what it had not received during the current year."

And this language was cited with approval by the District Court for the Western District of Louisiana in *United States* v. *Christine Oil & Gas Co.,* 269 Fed. 458.

In *Southern Pacific R. Co.* v. *Muenter,* 260 Fed. 837, decided by the Circuit Court of Appeals for the Ninth Circuit, a corporation had sold bonds at a discount which were to run for thirty-one years. It had set up on its books as a deduction from its income for each year of the thirty-one year period one-thirty-first part of the total discount. The case arose under the Tax Act of 1909 which permitted the deduction from gross income of all losses actually sustained during the year. The Court said:

> "We think the present case is determined adversely to the plaintiff-in-error by the plain language of the statute. The money set apart upon the books each year until the maturity of the bonds to meet the loss which

> came from selling the bonds below par was the application of a prudent and proper system of business and was a wise provision for the future; but it was not the payment of interest, nor did it represent a loss actually sustained within the year. The money was not in fact paid out. Notwithstanding the books of the plaintiff-in-error, the money is still in its possession and subject to its control. A system of bookkeeping will not justify the Government in claiming taxes, nor will it justify the taxpayer in claiming exemptions from taxpaying. The facts must control."

The Government seeks to support the contention that the expenditures involved here should be prorated by the regulation of the Commissioner of Internal Revenue above referred to, which requires such deductions to be prorated according to the number of years constituting the term of the lease, and which permits the annual deduction of only an aliquot part.

It is settled that the power to make administrative rulings does not include the power to legislate, *U. S.* v. *George*, 228 U. S. 14, and that such a regulation to be valid must be consistent with the statute under which it is made. *International Railroad Company* v. *Davidson*, 257 U. S. 506, 514. See also *Maryland Casualty* v. *U. S.*, 251 U. S. 342, 349 and cases cited.

Since the Revenue Act of 1916 specifically permits all of the expenditures mentioned therein which are made within the year to be deducted, the regulation of the Commissioner is in conflict therewith, and must fall. *Cryan* v. *Wordell*, 263 Fed. 248.

In dealing with this article of the regulations, the court below said:

> "A regulation of a governmental depart-

ment charged with the enforcement of an act has the force and effect of law, unless in itself it is unreasonable, inappropriate and inconsistent with express statutory provision. United States *v.* Morehead, 243 U. S. 607, 613; Maryland Casualty Co. *v.* United States, 251 U. S. 342, 349. The question is reduced to this: Is the insistence that these expenditures be prorated in each case according to the number of years constituting the term of the lease and that the aliquot part be deducted annually, inconsistent with the express provisions of the statute? The Statute expressly provides that all such rentals 'paid within the year' may be deducted 'from the gross amount of income received within the year' in order to ascertain the net income to be taxed. The evident intention of the statute is that the deduction of such rentals shall be made from the gross income '*within the year*' in which they are paid. McCoach *v.* Minehill Railway Co., 288 U. S. 295, 304. There is no hint in the statute that they shall be prorated over the term of years of the lease. We think that the provisions of the statute are plain, but if there be doubt, that doubt must be resolved against the Government. Gould *v.* Gould, 245 U. S. 151. That part of the regulation providing that only an aliquot part of such rentals shall be deducted each year during the life of the lease, we think, is inconsistent with the plain provisions of the statute." 289 Fed. 354, 358.

THE CONTENTIONS OF THE GOVERNMENT.

It is contended by the Government that the expenditures involved here should not be deducted from the Railroad Company's income for the year 1916 because they are capital expenditures. In support of this contention the Government cites certain language used by this court in the case of *Illinois Central Railroad Co.* v. *Interstate Commerce Commission,* 206 U. S. 441,

at page 462. In that case the court was called upon to review an order of the Interstate Commerce Commission holding certain advances in rates for the transportation of lumber unreasonable. It was urged, among other things, that the Commission had erred as a matter of law in failing to take into account in determining the reasonableness of the increased rates certain improvements claimed to have been made necessary by an abnormal increase of traffic. Upon this point the court held that even if the Commission were wrong as to such expenses, error in its ultimate conclusion was not demonstrated, nor was the correctness of its conclusion made so doubtful as to justify a reversal, for whether such improvements should be taken into account was a mixed question of law and fact upon which the finding of the Commission was conclusive. The language cited by the Government is, therefore, *dicta*, and the facts in the case clearly distinguish it.

In *Grand Rapids & I. Ry. Co.* v. *Doyle*, and in *Kemper* v. *Crutchley*, which the Government also cites, the improvements involved were made to the property owned by the corporations claiming the deductions. This fact clearly distinguishes those cases from the present case, for amounts expended from income for improvements, the title to which remains in the taxpayer, do not diminish the income. Money is simply invested. Such improvements are in fact, additions to the corporation's capital. But here title to the improvements involved vested in the lessors as soon as the Railroad Company made them, under the terms of the leases as well as by operation of law, for it is a familiar rule that when structures are erected by persons not owners of the land, they become part of the realty and,

as such, the property of the land owner. *Kutter* v. *Smith*, 2 Wall 491; *International Navigation Co.* v. *Barker*, 153 N. Y. 98; *Miller* v. *Gearin*, *supra*. While the improvements involved here became part of the capital investment of the lessors, so far as the Railroad Company is concerned, the amounts expended in making them represent merely expenditures in the nature of rentals, and while such improvements may increase the Railroad Company's income in the future, any such future income will be subject to taxation and the Government will lose nothing. See *Union Pacific Co.* v. *U. S.*, 99 U. S. 402.

But the determination of whether the Railroad Company is entitled to deduct the amounts involved in this case does not depend upon whether or not such amounts were capital expenditures. The only question here is whether the Railroad Company can bring them within the words of the statute when it is construed most strongly against the Government. If it can, it is entitled to deduct them.

Again it is urged that the deduction of the expenditures made in connection with the properties held under long term leases is contrary to the proviso of the second paragraph of Section 12 of the Act of 1916, reading as follows:

> "*Provided*, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate."

As the basis for this contention it is argued that while technically the Railroad Company is a lessee, it is in fact the potential owner of the properties held by it under long term leases, and it is urged that the court should consider sub-

stance and not form in determining the matter. This amounts to no more than an effort to induce the court to construe the act liberally in favor of the Government, but this the court may not do. The court cannot extend the provisions of the act, by implication, beyond the clear import of the language used, or enlarge its operations so as to embrace matters not specifically pointed out, and in case of doubt it must be construed most strongly against the Government and in favor of the citizen. *Gould* v. *Gould, supra,* and cases cited.

Since the Railroad Company is in fact a lessee, the court may not limit the right to make deductions given it by the act by treating it as a potential owner.

This contention, moreover, is in direct conflict with the interpretation placed on the act by the Commissioner of Internal Revenue. Article 140 of Regulations 33 (Revised) *supra,* expressly recognizes the right of a lessee to deduct expenditures made in permanently improving leased property, and this right is recognized irrespective of the term of the lease.

Additionally, even if the leasehold interests which the Railroad Company has in the properties involved here can be regarded as property or an estate in the sense in which these words are used in the act, the improvements made by it were not "made to increase the value" of such property or estate, but were made under the compulsion of the leases.

These considerations also answer the contention which is stated but not argued, that the expenditures involved here may not be deducted in full under Article 132 of the Regulations of the Commissioner of Internal Revenue, for the amounts expended here in fact added nothing to

the Railroad Company's capital investment, or to the value of its assets, for it lost title to the improvements involved as soon as it made them.

It is also urged that the expenditures involved may not be deducted because the leases did not require them to be made in 1916, but the statute imposes no such requirement. It provides that they may be deducted if they were paid within the year and were required to be made as rentals or as a condition to the continued use or possession of the property. The agreed statement of facts shows that the expenditures here were paid in 1916 and that the leases required them to be made.

With respect to the amounts expended in connection with New Pier 9, it is urged that they should not be deducted, because the lease contains a provision authorizing the lessor to terminate it before the end of its term and in such case requires the lessor to pay the lessee such reasonable sum as may be fixed by arbitration. But this does not justify denying the Railroad Company the right to deduct the amount it expended in connection with this pier from its gross income for the year in which such expenditures were made. The City may not terminate the lease, and if the Railroad Company must wait until the end of the term before its right to deduct these amounts is determined, it will lose the right to deduct anything, for by the terms of the statute it may deduct such amounts only wtihin the year in which they are expended. *Southern Pacific R. Co.* v. *Munter, supra;* while if the lease is terminated before the end of the term and anything is repaid to the Railroad Company as the result thereof, such amounts will be taxable as income for the year in which they are repaid.

Finally, it is argued that the enactment by Congress of a provision of the Revenue Act of 1918, almost identical with the provision of the Act of 1916 involved here, is an approval or ratification of the regulation of the Commissioner under the Act of 1916 upon the principle that Congress is presumed to have legislated with knowledge of the construction placed on a statute by the Executive Department of the Government charged with its administration. While this contention would be of great weight if the Act of 1918 were involved in this case, it cannot serve to justify a regulation under the Act of 1916, which, as has already been shown, is in plain conflict with the statute.

Conclusion.

IT IS RESPECTFULLY SUBMITTED THAT THE JUDGMENT BELOW SHOULD BE AFFIRMED.

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